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*IN THE*
*SUPREME COURT OF THE UNITED STATES*

October Term 1996

IN RE CHARLOTTE A. DORAND

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CHARLOTTE A. DORAND,
PETITIONER,

v.

RIGHT UP YOUR ALLEY, INC.,
AND ARLENE L. CREELY,
RESPONDENTS.

---

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

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# *PETITION FOR WRIT OF CERTIORARI*

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90 pp

## QUESTION PRESENTED FOR REVIEW

Whether the Court of Appeals and the District Court erred in setting aside the Bankruptcy Court's judgment on the merits in a dischargeability proceeding addressing the issue of fraud and defalcation under 11 U.S.C. § 523(a)(2)(A) and instead giving binding collateral estoppel effect to a prior state court judgment which did not clearly and specifically rest on a finding of fraud.

## PARTIES TO THE PROCEEDING IN THE COURT BELOW

The caption of the case contains the names of all parties below.

Respondent Right Up Your Alley, Inc., is not controlled by a parent company and does not own subsidiaries.

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## OPINIONS AND ORDERS ENTERED IN THE CASE

The decisions in this case include the Memorandum Opinion and Order of the United States Bankruptcy Court for the Eastern District of Louisiana of May 2, 1995; the Order and Reasons of the United States District Court for the Eastern District of Louisiana of February 5, 1996; the Order and Reasons of the District Court granting rehearing and reversing its prior judgment on March 25, 1996; the Opinion of the United States Court of Appeals for the Fifth Circuit filed on December 26, 1996; and the decision of the Court of Appeals denying rehearing filed on February 7, 1997. None of these decisions have been reported in any official or unofficial reports.

## BASIS FOR JURISDICTION

The judgment sought to be reviewed in this Court was entered by the United States Court of Appeals for the Fifth Circuit on December 26, 1996. The Court of Appeals subsequently entered its order denying rehearing of the case on February 7, 1997. The jurisdiction to grant a writ of certiorari in this case is conferred on this Court by 28 U.S.C. § 1254(1).

## STATUTES INVOLVED IN THE CASE

The following statutes are involved in this case:

> A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> . . . .
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

11 U.S.C. § 523(a)(2)(A).

> A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> . . . .
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

11 U.S.C. § 523(a)(4).

> A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> . . . .
>
> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

11 U.S.C. § 523(a)(6).

## STATEMENT OF THE CASE

### A. Basis for Jurisdiction in the Federal Courts Below

Original subject-matter jurisdiction over this core adversary proceeding was conferred on the United States Bankruptcy Court for the Eastern District of Louisiana by 28 U.S.C. § 1334(b) (district courts have original nonexclusive jurisdiction of all civil proceedings arising in or related to cases under Title 11), by 28 U.S.C. § 157(a) (district court may provide that proceedings arising in or related to a case under Title 11 shall be referred to the bankruptcy judges), by 28 U.S.C. § 157(b)(1) (bankruptcy judges may hear and determine all core proceedings arising in a case under Title 11), and by 28 U.S.C. §

157(b)(2)(I) (core proceedings include determinations as to the dischargeability of particular debts).

Appellate jurisdiction was conferred on the District Court by 28 U.S.C. § 158(a)(1) (district courts have jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under 28 U.S.C. § 157). Appellate jurisdiction was conferred on the Court of Appeals by 28 U.S.C. §§ 1291 and 1294(1) (courts of appeals have jurisdiction of appeals from all final decisions of the district courts in their circuit).

## B. Statement of the Facts

The case at bar began as a dispute over accounting services provided by the debtor for creditor Arlene L. Creely, owner of creditor Right Up Your Alley, Inc., in return for which the debtor was to be paid $275 a month. The debtor's services to creditor Creely were not satisfactory to her. Tax returns were not filed, although it is not clear that the debtor had contracted to file tax returns for the creditors, and other services were not performed, and, after the relationship was terminated, some of the creditors' records were not returned to them, although the Bankruptcy Court found the failure to have been unintentional. In addition, some of the services were performed during a period of time in which the debtor's license to practice as a Certified Public Accountant had been suspended, an omission for which the debtor lost her CPA license. The debtor terminated the employment relationship with Creely and her business in December of 1991.

The creditors subsequently filed an action against the debtor in the Louisiana District Court, complaining of the debtor's professional services. The creditors raised a variety of alternative theories to support their claims, including breach of contract, negligence, conversion, payment of a thing not due, unfair and deceptive trade practices, fraud, and open account. Defendant did not answer or appear and suffered default judgment to be entered against her. The state court judge entered judgment in favor of the creditors on April 7, 1992, stating, in pertinent part:

> IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, that judgment be rendered in favor of the plaintiffs and against the defendant, Charley A. Dorand, on the allegations of breach of contract, negligence, conversion, payment of a thing not due, unfair and deceptive trade practices, fraud, and open account.

(A-53.) The state court made no written findings or reasons in support of its judgment, and no transcript of the proceedings was preserved. (A-34.) About one year after the judgment, the debtor filed a motion to open the judgment and for leave to file an answer. The state court denied the motion, leaving in force the default judgment entered earlier. (A-51.)

The debtor subsequently filed for protection under Chapter 7 of the Bankruptcy Code on March 30, 1993. The creditors then filed this action in the Bankruptcy Court for the Eastern District of Louisiana, pursuant to 11 U.S.C. § 523(a)(2)(A), (obtaining money by false pretenses, false representation, or actual fraud), 11 U.S.C.

§ 523(a)(4) (fraud or defalcation while acting in a fiduciary capacity), 11 U.S.C. § 523(a)(6) (willful and malicious injury by the debtor to another entity), and 11 U.S.C. § 523(a)(11) (judgment arising from acts of fraud or defalcation while acting in a fiduciary capacity committed with respect to a depository institution).

After a full hearing and the testimony of several witnesses, the Bankruptcy Court found that the earlier state court judgment did not have collateral estoppel effect on the issue of fraud, because the state court had not made specific, subordinate factual findings in support of its judgment sufficient to demonstrate the prima facie elements of fraud under 11 U.S.C. § 523 (A-37), and because the state court awarded judgment on a variety of alterative grounds, indicating that fraud was not necessary to the judgment. (A-37.) The Bankruptcy Court also made detailed factual findings on the basis of the evidence presented. With respect to the creditors' claims under 11 U.S.C. § 523(a)(2)(A), the Court found the evidence insufficient to convince it that the debtor had known that her license had been suspended at the time that she agreed to perform services for the creditors (A-40), that she had knowingly misrepresented her status as a CPA (A-40), that she had undertaken to file tax returns for the creditors (A-40 to A-41), that the debtor had a power of attorney sufficient to authorize her to file tax returns for the creditors (A-40), and that the debtor had willfully failed to return to the creditors their original records. (A-41.) The Court specifically found that the creditors had failed to carry their burden of proof that the debtor had made any misrepresentations or had committed actual fraud. (A-41.) The Court also found that the debtor's failure to return some of the documents entrusted to her, which the Court found may have occurred (A-41), did not rise to the level

of false representation or actual fraud, there being no indication that the debtor had deliberately withheld the creditors' documents or had failed to return them with intent to deceive. (A-41.) Finally, the Court found that the failure to return documents did not cause any of the creditors' problems with the IRS. (A-41.) The Bankruptcy Court also found that the debtor was not a fiduciary of the creditors under 11 U.S.C. § 523(a)(4) (A-43), and that the debtor's actions complained of by the creditors had not been intentional and therefore could not rise to the level of willful and malicious injury intended in 11 U.S.C. § 523(a)(6). (A-45.) Finally, the Court found the evidence insufficient to prove that the actions complained of had caused the creditors' injury. (A-45.)

The creditors appealed to the District Court, which affirmed the decision of the Bankruptcy Court, finding that the Bankruptcy Court was not clearly erroneous in believing the debtor's testimony as to her lack of knowledge that her CPA license had been revoked (A-23), her testimony that she had undertaken to prepare tax returns for the creditors, but not to file them (A-24), that she had not represented to the creditors that she had filed tax returns for them (A-25), and that the decline in accounting services was owing to the fact that the creditors had been experiencing financial difficulties at the time. (A-25.) The District Court also held that the prior state court judgment could not be collateral estoppel on the issue of nondischargeability for fraud and defalcation, because it had not been demonstrated that the tort of fraud in Louisiana requires a showing of reliance. (A-22.)

The creditors then filed a Motion for Rehearing before the District Court, seeking to have the prior state court judgment given collateral estoppel effect and arguing

that Louisiana law requires the same showing of reliance in fraud claims. The District Court granted the motion and reversed its opinion and that of the Bankruptcy Court on the ground that the tort of fraud in Louisiana does indeed require a showing of reliance, rendering it sufficiently similar to a claim of nondischargeability under § 523 of the Bankruptcy Code as to mandate granting of the creditors' petition. (A-14.)

The debtor filed her Notice of Appeal to the Court of Appeals for the Fifth Circuit on April 22, 1996. On December 26, 1996, the Court of Appeals affirmed the judgment of the District Court. (A-3.) The debtor petitioned the Court for rehearing, which the Court of Appeals denied on February 7, 1997. (A-1.)

## REASONS FOR GRANTING THE WRIT

### I. INTRODUCTION.

The merits of this case turned on the facts and the credibility of witnesses. As the District Court noted, "the stories of appellants and appellee diverge widely as to the events that transpired." (A-16; *see also* A-30 (noting that the testimony of Creely and Dorand was, with certain exceptions, contradictory "on virtually all . . . relevant issues").) Accordingly, after hearing the testimony of various witnesses, the Bankruptcy Court made detailed findings of fact as to all the issues of the case and held that the creditors had failed to meet their burden of proof on any of their claims for nondischargeability, in particular on that of fraud. The only reason that the District Court later

reversed itself to find for the creditors lay in its view that the doctrine of collateral estoppel applied to prevent it, and the Bankruptcy Court, from hearing the issues at all.

The claim of collateral estoppel to support the claim of fraud rested on a judgment which, except for its mere mention of the word, did not support a fraud claim at all. The judgment was awarded on seven alternative grounds, each of which standing alone at least arguably supported the judgment. No findings as to fraud, or indeed about anything else, were made. To apply the doctrine of collateral estoppel, the District Court was obliged to strain to find that it was at least conceivable that the state court's judgment had necessarily rested on a finding of fraud sufficient to support a federal judgment of nondischargeability. This was clearly in violation of the decisions of this Court, which require that a state court judgment as to an issue be given collateral estoppel effect only if the issue was fully and necessarily found by the state court.

The District Court's opinion and the decision of the Court of Appeals upholding it have had the effect of endangering the protection of debtors given them by the Bankruptcy Code and the decisions of this Court. The casual implication of fraud in civil litigation, an all too common problem, will, if permitted to thrive in the bankruptcy context, threaten the discharge of debts for all debtors.

To except a debt from discharge, pursuant to § 523(a)(2)(A), a creditor must establish, by a preponderance of the evidence, (1) that the debtor made a false representation with the purpose and intention of deceiving the creditor; (2) that the creditor relied on the

representation; (3) that the reliance was reasonably founded; and (4) that the creditor sustained a loss as a result of the representation. *Johannessen v. Fuller* (*In re Johannessen*), 76 F.3d 347, 350 (11th Cir. 1996); *In re Britton*, 950 F.2d 602, 604 (9th Cir. 1991) (same, in five-part test). It is significant that the creditors in this case were unable to establish any of these factors to the satisfaction of the Bankruptcy Court, particularly with regard to the first factor of a false statement made with fraudulent intent.

It was also the creditors' burden to show the District Court on appeal why the Bankruptcy Court's findings of fact on these issues were clearly erroneous, which they also failed to do. Just what the creditors succeeded in showing in the state court is impossible to say. The debtor was not present (the case being a default one), either no record of the proceedings was made or it was lost or destroyed, and no findings were made. To blindly give such a judgment collateral estoppel effect in a federal nondischargeability proceeding would be to abdicate the responsibility of the federal court in nondischargeability hearings. And yet the lower courts did just that, setting aside the only trial on the merits in which both sides were heard and substituting in its place a vaguely and inconclusively worded judgment that probably did not find fraud at all. It is the failure of the Court of Appeals to reverse the District Court's unfortunate ruling which petitioner would request this Court to remedy.

## II. THE COURT OF APPEALS ERRED IN AFFIRMING THE DISTRICT COURT'S RULING THAT THE STATE COURT JUDGMENT WAS BINDING ON THE BANKRUPTCY COURT ON THE ISSUE OF NONDISCHARGEABILITY FOR FRAUD.

In applying collateral estoppel, the court looks to the law of the state regarding collateral estoppel. *Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 384 (1985); *see also Kremer v. Chemical Construction Corp.*, 456 U.S. 461, 466 (1982) (full faith and credit requires federal courts to give same preclusive effect to state court judgments that those judgments would be given in the court of the state from which the judgments emerged). Put another way, a federal court may give no greater preclusive effect to state court judgments than would the courts of that state themselves. *Johnson v. Grandy*, 114 S. Ct. 2647, 2654 (1994); *Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. at 384. The Louisiana doctrine of issue preclusion provides:

> A judgment in favor of either the plaintiff or the defendant is conclusive, in any subsequent action between them, with respect to any issue actually litigated and determined if its determination was essential to that judgment.

La. Rev. Stat. Ann. § 13:4231(3) (West 1991). The party urging an issue preclusion must provide each of its essential elements by a preponderance of the evidence.

*Ebey v. Harvill*, 647 So. 2d 461, 463 (La. Ct. App. 2d Cir. 1994). Of most significance to the case at bar, Louisiana requires that any doubt as to the applicability of issue preclusion results in the second action being maintained. *Id.* at 463; *State Department of Social Services v. Matthews*, 615 So. 2d 1112, 1114 (La. Ct. App. 5th Cir. 1993) (in res judicata context). The Louisiana rule of issue preclusion is consistent with the general rule.

> When an issue of fact or law is actually litigated and determined by a valid and final judgment, *and the determination is essential to the judgment*, the determination is conclusive in a subsequent action between the parties, whether on the same or a different claim.

Restatement (Second) of Judgments § 27 (1982) (emphasis added).

The requirement of this important element of necessity in collateral estoppel—the issue in this case—is well established as a general rule in the opinions of this Court. *See United States v. Mendoza*, 464 U.S. 154, 158 (1984) (once court has decided issue necessary to its judgment, that decision is conclusive); *Kremer v. Chemical Construction Corp.*, 456 U.S. at 466 n.6 (under collateral estoppel, once court decides issue of fact or law necessary to its judgment, that decision precludes relitigation of the same issue) (citing *Montana v. United States*, 440 U.S. 147, 153 (1979); *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 326, n. 5 (1979)); *Allen v. McCurry*, 449 U.S. 90, 94 (1980) ("[O]nce a court has decided an issue of fact or law necessary to its judgment, that decision may preclude relitigation of the issue in a suit on a

different cause of action involving a party to the first case"). The finding of necessity is particularly vital in nondischargeability proceedings in bankruptcy. Without this limitation, issue preclusion in the federal courts would take on an unintended scope, with the result of seriously hampering the discharge process. Any finding, or even dictum, no matter how tangential to the controversy, would have binding effect in later nondischargeability hearings.

In giving collateral estoppel effect to the prior state court judgment, the Fifth Circuit did not apply these principles. The state court judgment recited several alternative grounds for judgment, nearly any one of which would have supported the judgment alone, making the others nonessential to the judgment. The Louisiana court simply ruled that

> judgment be rendered in favor of the plaintiffs and against the defendant, Charley A. Dorand, on the allegations of breach of contract, negligence, conversion, payment of a thing not due, unfair and deceptive trade practices, fraud, and open account.

(A-53.) The state court's ruling simply awarded judgment, repeating in cursory and mechanical fashion the language of the plaintiffs' complaint. The court made no findings of fact, making it impossible to state, with any degree of certainty, just what the basis for judgment was. The court did not make any allocation among the various theories that might have provided a basis for determining that, nor did it give any explanation which might have supported a federal conclusion that fraud had actually been litigated. It was thus impossible to conclude that a finding of fraud

was "essential to the determination" in the state court, and the prior judgment of the Twenty-Fourth Judicial District Court ought never to have been given preclusive effect as to the issue of whether fraud was committed.

Recognizing the difficulty inherent in finding that the state court judgment necessarily embraced fraud, the District Court at first dismissed the creditors' claims. (A-15.) On petition for rehearing, however, the District Court attempted to do indirectly what it, and the Bankruptcy Court before it, had been unable to do directly, namely, to perceive in the state court's judgment a binding adjudication of fraud against the debtor. The District Court did this by analyzing, in painstaking detail, the relief awarded by the state court, in an attempt to deduce that a finding of fraud could have been made, despite the silence of the state court on the subject, the absence of factual findings, and the presence of six other grounds to support the judgment. The Court held that the award of general damages by the state court necessarily implied at least more than contract. (A-13.) This conclusion was unwarranted since general damages may be awarded for breach of contract. *See* Charles T. McCormick, *Handbook of the Law of Damages* § 8, at 32-33 (1935) (general damages are those which flow necessarily from the breach or wrong, and special damages are those which must be specifically pleaded); 11 Samuel Williston, *A Treatise on the Law of Contracts* § 1344A, at 229 (Walter H.E. Jaeger 3d ed. 1968) (proximate and natural damages for breach of contract are general damages, while damages for other consequences are special damages). There was no reason to conclude, from the mere award of general damages, that fraud was necessarily implicated in the state court's judgment, since such damages may be awarded whenever called for by the circumstances. *See Kessler v. Southmark*

*Corp.*, 643 So. 2d 345, 351 (La. Ct. App. 2d Cir. 1994) (general damages are those which may not be fixed with pecuniary exactitude, but which involve mental or physical pain or suffering, inconvenience, or other losses which cannot be definitely measured in monetary terms). In fact, an award of general damages is a matter of course in Louisiana and certainly does not require a finding of fraud. *See Pagan v. Shoney's, Inc.*, 931 F.2d 334, 337 (5th Cir. 1991) (in slip-and-fall case, failure to grant general damages to plaintiff with objective injuries was outside discretion allowed by La. Civ. Code Ann. art. 2324.1). The District Court's attempt to divine a finding of fraud from the nature of the damages was all the more inapposite, since the scope of relief by way of damages is particularly broad in Louisiana. *See* La. Civ. Code Ann. art. 2315 (West Supp. 1996) ("[E]very act whatever of man that causes damages to another obliges him by whose fault it happened to repair it"); La. Civ. Code Ann. art. 1994 (West 1987) (obligor liable for damages caused by failure to perform a conventional obligation).

In much the same vein, the Fifth Circuit laid emphasis on the fact that attorney's fees were awarded by the state court, which must have indicated that fraud was found. (A-9.) This conclusion, however, was unwarranted since attorney's fees may be awarded in Louisiana in a variety of claims besides those of fraud. *See, e.g., McHale v. Lake Charles American Press*, 390 So. 2d 556, 571 (La. Ct. App. 3d Cir. 1980) (libel action), *cert. denied*, 452 U.S. 941 (1981); *Philippe v. Browning Arms Co.*, 395 So. 2d 310, 318 (La. 1980) (redhibitory action for avoidance of a sale on account of vice or defect in thing sold, rendering it useless or imperfect); *Delta Refrigeration Co. v. Upjohn Co.*, 432 F. Supp. 124, 126-27 & n.2 (W.D. La. 1977), *aff'd*, 575 F.2d 879 (5th Cir.), *cert. denied*, 439 U.S. 984

(1978) (same); *Cvitanovich v. Sorli*, 347 So. 2d 1204, 1207 (La. Ct. App. 1st Cir. 1977) (action for wrongful seizure of movable property); La. Rev. Stat. Ann. § 9:2781(A) (West 1991) (recovery of debt on open account). The Court of Appeals reasoned that

> Dorland also notes correctly that under Louisiana law, attorneys' fees are recoverable for other causes of action besides fraud alone. *See, e.g., McHale v. Lake Charles Am. Press*, 390 So. 2d 556 (La. App. 3d Cir. 1980), *cert. denied*, 452 U.S. 941 (1981) (awarding attorneys' fees in a libel case).
>
> Only one of these additional causes of action for which Dorland notes that attorneys' fees are available, however, was pleaded by Creely—an action on open account. Creely concedes that attorneys' fees are available in an action on open account but argues convincingly that the state court likely did not base its award of attorneys' fees of $4,505.15 on an open account claim of $686.50, as such an award (600% of the damages claimed) would have been excessive under the Louisiana reasonableness standards.

(A-8 to A-9.) A finding of preclusion on the issue of fraud required more than this kind of speculation. The Court was unable to say that fraud was definitely found. It could only conclude that it was likely that fraud was found, which hardly ought to have precluded the issue. As a matter of fact, even as speculation, the Court's conclusion

may have been incorrect. The state court might have had in mind, perhaps erroneously, that attorney's fees could be awarded for negligence or an aggravated breach of contract. Its award of attorney's fees hardly mandates the irrebuttable conclusion that fraud was necessarily and specifically found.

In taking the approach they did, both the Court of Appeals and the District Court actually reversed the proper method of determining whether to apply collateral estoppel. Instead of finding that fraud *must have been* a necessary ground for the state court's judgment—making it binding on the Bankruptcy Court on the issue of nondischargeability—the District Court, and the Court of Appeals in affirming it, found only that fraud *could have been* a reason for the state court's judgment.

> It is true that under certain of the theories of recovery asserted, all of these items of damages were not recoverable. For example, the appellants ordinarily would not have been entitled to attorneys fees if they had succeeded only on the negligence claim. And appellants likely would not have been entitled to general damages if they had succeeded only on the breach of contract theory or payment of a thing not due. However, *each of the items of damages prayed for was recoverable under the theory of fraud*, and there simply exists no basis for appellee's contention that any of these items of loss include any amounts not recoverable under the fraud theory.

(A-13 to A-14 (emphasis added).)

Whether these items were or were not recoverable under the various theories of the complaint is besides the point. The issue is whether fraud must have been the ground for the state court's decision. In reality, it seems most likely that the state court had nothing more in mind than entering a default judgment which simply repeated the grounds of the creditors' complaint, making no findings as to fraud and likely enough not even considering the issue.

## III. THE OPINIONS OF THE DISTRICT COURT AND THE COURT OF APPEALS WILL HAVE THE EFFECT OF IMPROPERLY REMOVING THE PROTECTION CONGRESS CONFERRED ON DEBTORS IN THE BANKRUPTCY CODE.

The policy of the Bankruptcy Code is to protect debtors and give them a new start in their economic affairs.

> "One of the primary purposes of the Bankruptcy Act" is to give debtors "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt." . . . There can be no doubt . . . that Congress intended this "new opportunity" to include freedom from most kinds of pre-existing tort judgments.

*Perez v. Campbell*, 402 U.S. 637, 648 (1971) (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934)) (citations omitted); *cf. Kokoszka v. Belford*, 417 U.S. 642, 651 (1974) (if, despite consumer protection acts, debtor fails, protection and remedies under bankruptcy laws remain). If the protection of the Bankruptcy Code is to have any real effect, debtors must be protected against lightly made charges of fraud, a serious charge which is *never* presumed under federal law.

It is indeed a fundamental policy of the common law that fraud in civil litigation is not lightly to be presumed. *See Stromberger v. 3M Co.*, 990 F.2d 974, 978 (7th Cir. 1993) (fraud in sense of deliberate deceit cannot be inferred from falsity alone); *Diduck v. Kaszycki & Sons Contractors, Inc.*, 974 F.2d 270, 276 (2d Cir. 1992) (same); *Keith v. Stoelting, Inc.*, 915 F.2d 996, 1000 (5th Cir. 1990) (conclusory allegations of fraud are not sufficient to survive dismissal); *National Farmers Organization, Inc. v. Kinsley Bank*, 731 F.2d 1464, 1473 (10th Cir. 1984) (fraud is never presumed); *Lessmann v. Commissioner*, 327 F.2d 990, 993 (8th Cir. 1964) (same); *Sahadi v. Commissioner*, 266 F.2d 495, 501 (3d Cir.), *cert. denied*, 361 U.S. 874 (1959) (same). Carelessness, which may have been all that occurred in the instant case, cannot support an inference of fraud. *Brazell v. First National Bank & Trust Co. of Rockford*, 982 F.2d 206, 208 (7th Cir. 1992). Rather,

> [f]raud implies bad faith, intentional wrong doing and a sinister motive. It is never imputed or presumed and the courts should not sustain findings of fraud upon circumstances which at the most create only suspicion.

*Davis v. Commissioner*, 184 F.2d 86, 87 (10th Cir. 1950) (footnote omitted).

The unintended effect of giving binding collateral estoppel effect to the vaguely worded state court judgment in this case was to violate this fundamental rule in the bankruptcy context. This is curious since the rules cited earlier for application of the doctrine of collateral estoppel are as well defined in the Fifth Circuit as anywhere.

> [C]ollateral estoppel—arising from an earlier nonbankruptcy suit's determination of subsidiary facts that were *actually litigated and necessary to the decision*—may properly be invoked by the bankruptcy court to bar relitigation of those issues, even though the bankruptcy court retains the exclusive jurisdiction to determine the ultimate question of the dischargeability [of the debt] under federal bankruptcy law[.]

*Matter of Garner*, 56 F.3d 677, 681 (5th Cir. 1995) (quoting *In re Shuler*, 722 F.2d 1253, 1355 (5th Cir.), *cert. denied*, 469 U.S. 817 (1984)) (emphasis added); *see also Recoveredge L.P. v. Pentecost*, 44 F.3d 1284, 1290 (5th Cir. 1995) (for collateral estoppel to apply, determination of the issue at stake must have been a necessary part of the judgment in the earlier proceeding).

That the lower courts' opinions are a threat to the discharge in bankruptcy generally is suggested by the opinion in *Fielder v. King*, 103 F.3d 17 (5th Cir. 1997), in which the Fifth Circuit allowed a creditor to assert a fraud claim apparently previously disallowed by a state court.

The plaintiffs had sued for breach of contract, adding a count for fraud as well. The jury awarded actual damages and punitive damages, which latter relief the state court disallowed without comment. When the debtor raised a collateral estoppel defense in the later nondischargeability proceeding, the Fifth Circuit held that issue preclusion was barred for the lack of specific factual findings.

> The state-court record presented for our review does not meet the requirements set out in *Dennis*. The record reflects no "specific, subordinate, factual finding" that King's debt to the Fielders was not obtained by false pretenses, false representations, or actual fraud. Moreover, the record is devoid of facts to support such a finding, even had such a finding been made. The party asserting issue preclusion bears the burden of proof, *Sysco Food Servs., Inc. v. Trapnell*, 890 S.W.2d 796, 801-02 (Tex.1994), and hence would have the burden of bringing forward an adequate state-court record.
>
> King essentially argues that the substituted state-court judgment, which awarded contract damages and denied "all relief not expressly granted," constitutes a specific finding that King did not obtain the debt by false pretenses, false representation, or actual fraud. We disagree. The bare fact that the state court awarded only contract rather than fraud damages does not preclude the bankruptcy court from inquiring into the true nature of that debt. . . . We have

> admonished bankruptcy courts to "look beyond the labels which state courts . . . give obligations which debtors seek to have discharged."

*Id.* at 19-20. In the case at bar, the concern for "specific, subordinate, factual finding[s]" disappears when the debtor raises the same concern. Also, in marked contrast to the case at bar, the Court of Appeals in *King* particularly went out of its way to decline to speculate as to how the state court had ruled, the very thing which it did here.

> The bankruptcy court itself stated that the determination that the Fielders' claim sounded in contract rather than fraud was made for reasons "only known to the state court judge." Under these circumstances, the state court's elimination of fraud damages can hardly be construed as a specific factual finding regarding the federal law dischargeability issue.

*Id.* at 20.[1] It is difficult to explain the result in *King*, given the principles of collateral estoppel so carefully and correctly defined elsewhere in opinions of the circuits, the Fifth included, other than as a willingness to allow the protection of debtors in bankruptcy to be eroded. The intervention of this Court is therefore required to protect

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[1] *King* involved Texas law, but this fact does not distinguish the result. The same rules were applied as apply here, and the Court, in fact, cited federal law for the rules of decision.

debtors' discharge lawfully granted in bankruptcy proceedings.

## CONCLUSION

For all the reasons set forth above, the Petitioner respectfully requests that this honorable Court grant the Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,

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Telephone (504) 887-0379

Attorney for Petitioner

NO. _____

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*IN THE*
*SUPREME COURT OF THE UNITED STATES*

October Term 1996

IN RE CHARLOTTE A. DORAND

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CHARLOTTE A. DORAND,
PETITIONER,

v.

RIGHT UP YOUR ALLEY, INC.,
AND ARLENE L. CREELY,
RESPONDENTS.

---

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

---

*APPENDIX*

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IN THE UNITED STATES
COURT OF APPEALS

FOR THE FIFTH CIRCUIT

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No. 96-30445

---

In The Matter Of: CHARLOTTE A DORLAND

Debtor

---

RIGHT UP YOUR ALLEY; ARLENE L CREELY

Appellees

v.

CHARLOTTE A DORLAND

Appellant

---

Appeal from the United States District Court for
the Eastern District of Louisiana, New Orleans

---

ON PETITION FOR REHEARING

Before SMITH, DUHE, and BARKSDALE, Circuit Judges

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above case is DENIED.

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ENTERED FOR THE COURT:

*/s/ J. Smith*
United States Circuit Judge

CLERK'S NOTE:
SEE FRAP AND LOCAL RULES 41 FOR STAY OF THE MANDATE.

IN THE UNITED STATES COURT
OF APPEALS

FOR THE FIFTH CIRCUIT

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No. 96-30445
Summary Calendar

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In the Matter of:

CHARLOTTE A. DORLAND,

Debtor.

CHARLOTTE A DORLAND,

Appellant,

VERSUS

RIGHT UP YOUR ALLEY, INC., and
ARLENE L. CREELY,

Appellees.

---

Appeal from the United States District Court
for the Eastern District of Louisiana
(95-CV-2200 L)

Before SMITH, DUHE, and BARKSDALE, Circuit Judges.

JERRY E. SMITH, Circuit Judge:*

In this bankruptcy action, the debtor, Charlotte Dorland, appeals the district court's determination that a Louisiana state court default judgment has preclusive effect on appellees' dischargeability action under 11 U.S.C. § 523(a)(2)(A). Finding no error, we affirm.

I.

Arlene Creely retained Dorland in 1990 to perform various accounting and tax services on her behalf and on behalf of her business, Right Up Your Alley, Inc.[1] After terminating the employment relationship in January 1992, Creely sued Dorland in Louisiana state court, alleging breach of contract, negligence, conversion, payment of a thing not due, unfair and deceptive trade practices, fraud, and open account. When Dorland failed to answer the complaint, the state court held an evidentiary hearing and rendered a default judgment in favor of Creely, awarding actual damages, general damages, and attorneys' fees.[2]

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*Pursuant to 5TH CIR. R. 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

[1]Creely and Right Up Your Alley, Inc., collectively, are referred to hereinafter as "Creely").

[2]The default judgment noted in pertinent part that "IT IS ORDERED, ADJUDGED AND DECREED that

Subsequent to this adverse judgment, Dorland filed in March 1993 a voluntary chapter 7 bankruptcy petition. Pursuant to 11 U.S.C. § 523, Creely filed a complaint to determine dischargeability of debt in the bankruptcy court, arguing that the state court judgment with respect to fraud was entitled to collateral estoppel effect in the dischargeability determination. The bankruptcy court denied Creely's summary judgment motion on collateral estoppel, finding that the state court had not made subordinate, factual findings in support of its default judgment. The district court affirmed the bankruptcy court originally and then, upon motion for rehearing, reversed the bankruptcy court, finding that the court was required on the basis of collateral estoppel to give preclusive effect to the Louisiana state court judgment.

II.

Dorland argues that the district court erred in giving preclusive effect to a Louisiana state court default judgment in its determination that the debts to Creely are nondischargeable under 11 U.S.C. § 523(a)(2)(A).[3] We

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judgment be rendered in favor of the plaintiffs and against the defendant, Charley A. Dorand, on the allegations of breach of contract, negligence, conversion, payment of a thing not due, unfair and deceptive trade practices, fraud, and open account."

[3]Section 523(a)(2)(A) excepts from discharge any debts "'to the extent obtained by . . . false pretenses, a false representation, or actual fraud, other than a statement

review the district court's conclusions of law *de novo* and its factual findings for clear error. *See Allison v. Roberts (In re Allison)*, 960 F.2d 481, 483 (5th Cir. 1992).

We are required, under the Full Faith and Credit Act, 28 U.S.C. § 1738, to accord state court judgments the same preclusive effect that is provided by the law of the state in which the judgment was rendered. *See A.L.T. Corp. v. Small Business Admin.*, 801 F.2d 1451, 1455 (5th Cir. 1986). Under Louisiana law, collateral estoppel bars relitigation of "'any issue actually litigated and determined if its determination was essential to that judgment.'" *State Dep't of Social Serv. v. Matthews*, 615 So. 2d 1112, 1113 (La. App. 1st Cir. 1993) (citing LA. REV. STAT. ANN. § 13:4331(3) (West 1991)).

Dorland contends that, because the state court entered a default judgment, the fraud claim was neither "actually litigated" nor "essential to that judgment." According to Dorland, "the state court simply awarded judgment, repeating in cursory and mechanical fashion the language of the plaintiffs' complaint. . . . There is simply no way of knowing which grounds were seriously considered by the state court nor which were considered essential to its judgment." Furthermore, Dorland argues that, notwithstanding the award of actual damages, special

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respecting the debtor's or an insider's financial condition.'" *See RecoverEdge L.P. v. Pentecost*, 44 F.3d 1284, 1292 (5th Cir. 1995) (quoting 11 U.S.C. § 523(a)(2)(A)). Because Dorland does not appeal the district court's finding that fraud under Louisiana law is tantamount to "actual fraud" under U.S.C. § 523(a)(2)(A), we assume as much for the purposes of this appeal.

damages, and attorneys' fees, all three of which are recoverable together only upon a finding of fraud, we cannot infer from this award that the court actually found fraud.

"It is well established that in obtaining a default judgment, the plaintiff must present competent evidence to support each element of his causes as fully as though each of the allegations in the petition were [sic] denied by defendant." *Collins v. Estrade*, 638 So. 2d 275, 277 (La. App. 5th Cir. 1994). Thus, under Louisiana law, a default judgment requires that the plaintiff make out a *prima facie* case for each of the claims alleged. *See* LA. CODE CIV. PROC. ANN. art. 1702A (West 1991).

It is evident from the state court's final order that the court considered the fraud allegations and that, as a pre-condition to awarding a default judgment with respect to the fraud claim, the court determined that Creely had successfully proved the *prima facie* case for fraud. An issue that is properly raised, by the pleadings or otherwise, and that is submitted for determination and is actually determined is "actually litigated" for purposes of collateral estoppel. *See Garner v. Lehrer (In re Garner)*, 56 F.3d 677, 680 (5th Cir. 1995) (applying the same default judgment standard under Texas law as is applicable to Louisiana law). Hence, we disagree with Dorland that the state court "simply awarded judgment" without determining first that Creely had "actually litigated" the elements of fraud.

We similarly reject Dorland's argument that the fraud finding was not "essential to that judgment."[4] The district court found that because the court awarded Creely its full actual damages, general damages, and attorneys' fees, all three of which are available under Louisiana law under a finding of fraud only, the fraud finding was essential to the default judgment. Dorland notes correctly, however, that under Louisiana law the state court could have awarded general damages for other causes of action (i.e., negligence) pleaded by Creely besides fraud alone. *See Kessler v. Southmark Corp.*, 643 So. 2d 345, 351 (La. App. 2d Cir. 1994). Dorland also notes correctly that under Louisiana law, attorneys' fees are recoverable for other causes of action besides fraud alone. *See, e.g., McHale v. Lake Charles Am. Press*, 390 So. 2d 556 (La. App. 3d Cir. 1980), *cert. denied*, 452 U.S. 941 (1981) (awarding attorneys' fees in a libel case).

Only one of these additional causes of action for which Dorland notes that attorneys' fees are available, however, was pleaded by Creely—an action on open account. Creely concedes that attorneys' fees are available

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[4]This is an unusual posture in which to raise a challenge under the "necessary to that judgment" prong of the collateral estoppel test. Typically, such challenges arise where a litigant seeks to estop the re-litigation of one element of an ultimate claim, whereas here the challenge is to the claim itself. *See, e.g., Ebey v. Harvill*, 647 So. 2d 461, 464 (La. App. 2d Cir. 1994) (noting that a claimant's statement regarding paternity made in a previous divorce action is not preclusive in a subsequent action because paternity was not essential to the final judgment in the divorce proceedings).

in an action on open account but argues convincingly that the state court likely did not base its award of attorneys' fees of $4,505.15 on an open account claim of $686.50, as such an award (600% of the damages claimed) would have been excessive under the Louisiana reasonableness standards. Hence, we do not find clear error in the district court's finding that, of the various claims alleged by Creely, all three forms of awards—actual damages, general damages, and attorneys' fees—were available and actually awarded for the fraud claim only. A finding of fraud was therefore necessary to the default judgment, notwithstanding the fact that each of the various claims arose out of the same set of operative facts.

AFFIRMED.

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF LOUISIANA

RIGHT UP YOUR ALLEY, INC., ET AL

VERSUS

CHARLOTTE A. DORAND

CIVIL ACTION

NO. 95-2200

SECTION "L"

## ORDER AND REASONS

This matter is before the Court on appeal from a final judgment of the United States Bankruptcy Court, Eastern District of Louisiana, entered on May 22, 1995, against plaintiffs and in favor of debtor on plaintiffs' complaint to determine the dischargeability of a debt. On February 6, 1996, the Court issued its Order and Reasons affirming the Bankruptcy Court's decision. Before the Court is the appellant's Motion for Rehearing, to which the appellee has filed a timely opposition. For the reasons that follow, the Motion for Rehearing is GRANTED.

The factual background of this case and relevant law are set forth in this Court's Order and Reasons of February 6, 1996, pages 1 through 5 of which the Court adopts herein. The appellants limit their request for reconsideration to this Court's determination, expressed on page 6 of the Order and Reasons, that the necessary elements of fraud under Louisiana law, unlike the elements required to establish nondischargeability for "false representation or false pretense" under § 523(a)(2)(A), do not include reliance.

In support of their motion the appellants cite several cases, not cited in their original briefs, which indicate that reliance is indeed an essential element of fraud under Louisiana law. See, e.g., Abell v. Potomac Insurance Co., 858 F.2d 1104, 1131 n.33 (5th Cir. 1988). The Fifth Circuit in Abell explains the elements of Louisiana fraud as follows: "(1) a misrepresentation of a material fact, (2) made with the intent to deceive, and (3) causing justifiable reliance with resultant injury." Id.; see also Lacroix v. Recknagle, 89 So. 2d 363 (La. 1956). This definition is based on former Louisiana Civil Code article 1847, the predecessor to article 1953. See Abel [sic], 858 F.2d at 1131 n. 33. Although neither former article 1847 nor the present article 1953 expressly state reliance as a necessary element of fraud, courts interpreting 1847 clearly have read the requirement as being implicit in the article's definition. As article 1953 essentially restates the definition found in article 1847 and does not change the law, it would appear that the jurisprudential element of reliance abides in article 1953 as well. See La. Civ. Code Ann. art. 1953, comment (a) (West 1987).

The appellee, in her opposition, has directed the Court to no law indicating that reliance is not a necessary element of fraud under Louisiana law. Accordingly, the Court finds that a determination of each of the elements required to establish nondischargeability for "false representation or false pretense" under § 523(a)(2)(A) was essential to the state court's rendering of judgment on the fraud claim. La. Rev. Stat. Ann. § 13:4231(3) (West 1991).

Although the appellee has offered nothing to contradict the appellants' arguments regarding the law of issue preclusion, the requirements of § 523(a)(2)(A), or the

elements of fraud under Louisiana law, the appellee did raise a contention during oral argument that warrants some discussion. Appellee argues that the state court judgment should not be given preclusive effect because fraud was not the only cause of action addressed in the judgment and not the only the [sic] grounds for awarding damages to the appellants. Appellee contends that it is impossible to determine what amount of the damages awarded was based on fraud and what amount, if any, was based upon some other cause of action.[1] Although this argument has some appeal at first glance, it cannot withstand scrutiny.

The problem with appellee's reasoning is that the appellants, in the state court action, did not allege different injuries attributable to separate claims. Rather, the appellants asserted several different theories of recovery based upon the same set of facts—namely, that appellee misrepresented that she had performed work which she had not performed, that she had continued to accept payment for work never performed, and that she had induced appellants into inaction with regard to tax filings. Based upon this set of factual allegations, the appellants sought damages (under several theories of recovery) for three categories of loss: 1) actual monetary damages (money that appellants had paid to appellee, as well as money paid to others in an effort to resolve their tax crisis), 2) general damages (for emotional anguish, disruption of business, humiliation, etc.), and 3) costs and

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[1]The state court rendered judgment against the appellee and in favor of the appellants on the appellants' claims of breach of contract, negligence, conversion, payment of a thing not due, unfair and deceptive trade practices, fraud, and open account.

attorneys fees. The state court awarded $11,700.57 in actual damages and $4,505.15 for attorneys fees and costs.[2] With regard to general damages the appellants simply prayed for a "reasonable amount," and the state court awarded $7,500.

A plaintiff may not recover more than once for the same injury. Even where, as here, a plaintiff prevails on more than one claim, she is entitled to be made whole only once. See, e.g., Brown v. Drillers, Inc., 630 So. 2d 741, 758 (La. 1994); Guillory v. State Farm Ins. Co., 662 So. 2d 104, 118 (La. Ct. App. 1995) (where no additional damages are proved in connection with alternative theories of recovery, "a finding of liability . . . in connection with any of those claims would not increase the amount of award to which the plaintiff is entitled"). Thus, even though the appellants succeeded on more than one theory of recovery, they were compensated for each item of loss only once.

It is true that under certain of the theories of recovery asserted, all of these items of damages were not recoverable. For example, the appellants ordinarily would not have been entitled to attorneys fees if they had succeeded only on the negligence claim. And appellants likely would not have been entitled to general damages if they had succeeded only on the breach of contract theory or payment of a thing not due. However, each of the items of damages prayed for was recoverable under the theory of

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[2]These are the precise the [sic] amounts prayed for in the appellants' calculation of damages contained in their memorandum in support of confirmation of default, which calculation was supported by detailed documentation.

fraud, and there simply exists no basis for appellee's contention that any of these items of loss include any amounts not recoverable under the fraud theory.

For the foregoing reasons, the Court finds that the state court default judgment should have been given preclusive effect in the discharge exception proceedings. Accordingly, IT IS ORDERED that the appellants' Motion for Rehearing is HEREBY GRANTED, this Court's order of February 6, 1996 is HEREBY VACATED, and the Judgment of the Bankruptcy Court is REVERSED.

Done this 25 day of March, 1996
New Orleans, Louisiana

/s/
UNITED STATES DISTRICT JUDGE

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF LOUISIANA

RIGHT UP YOUR ALLEY, INC., ET AL

CIVIL ACTION

VERSUS

NO. 95-2200

CHARLOTTE A. DORAND

SECTION "L"

## ORDER AND REASONS

Before the Court is an appeal from a final judgment of the United States Bankruptcy Court, Eastern District of Louisiana, entered on May 22, 1995, against plaintiffs and in favor of debtor on plaintiffs' complaint to determine the dischargeability of a debt. For the reasons that follow, the judgment of the Bankruptcy Court is AFFIRMED.

I. BACKGROUND: In May of 1990, plaintiff/appellant Arlene Creely retained debtor/appellee Charlotte Dorand to perform certain accounting and tax services on behalf of Creely and her hair salon business, plaintiff/appellant Right Up Your Alley, Inc. The Retention Agreement documenting this contract was prepared on appellee's letterhead, which represented appellee to be a Certified

Public Accountant, when in fact, appellee's certificate and license to perform public accounting had been suspended since March 1, 1990 for failure to pay fees.[1] In exchange for retainer payments of $275 per month, appellee was to prepare bank reconciliations, a general ledger and general journals, city sales tax returns, payroll tax returns, personal and corporate tax returns, as well as other accounting and tax services.

The stories of appellants and appellee diverge widely as to the events that transpired over the next two years. Appellants maintain that in the fall of 1991, appellant Creely learned from the Internal Revenue Service ("IRS") that appellants' quarterly tax returns for 1991 had not been filed. According to appellants, appellee had agreed to file tax returns on behalf of appellants, and a power of attorney had been executed giving appellee authority to do so. Under appellants' version of the facts, when appellant Creely confronted appellee with the news from the IRS, appellee told her that the returns had been filed (by appellee) and that Creely should not speak any further with the IRS, but should allow appellee to handle it. Appellants maintain that appellant Creely did instruct the IRS to direct their inquiries to appellee but that the IRS communicated with Creely again in November 1991, informing her that they had failed to reach appellee despite repeated attempts. According to appellants, appellant Creely then demanded that appellee return all of appellants' records, which appellee has never done.

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[1]Although the Retention Agreement is dated August 6, 1990, it was acknowledged by Creely on May 12, 1990, and appellee began preforming work for appellees in May 1990.

According to appellee, on the other hand, a power of attorney was never executed, and appellee agreed only to prepare appellants' tax returns, not to file them. Appellee maintains that she did prepare appellants' tax returns for the first, second, and third quarters of 1991 and that it was appellants' responsibility to file them. Appellee denies representing that the returns had been filed or instructing appellant Creely not to speak with the IRS. In addition, appellee maintains that she had returned all of appellants' records by December 1991. If any documents were missing, it is appellee's position that they must have been taken or misplaced when her office was robbed.

On February 27, 1992, appellants filed suit against appellee in Louisiana state court, Parish of Jefferson, seeking damages for breach of contract, negligence, conversion, payment of a thing not due, unfair and deceptive trade practice, fraud, open account, and return of records. Appellee did not timely answer, and a preliminary default was entered on March 24, 1992. On April 7, 1992, after taking documentary evidence and hearing testimony, the court confirmed the default and entered judgment in favor of appellants on each claim asserted, awarding $7,500.00 general damages, $11,700.57 actual damages, $4,505.15 costs and attorneys fees, plus legal interest and costs.

On September 11, 1992, after an administrative hearing at which appellee failed to appear, the State Board of Certified Public Accountants of Louisiana revoked appellee's license upon determining that she had violated legal standards in connection with her work for appellants, including failing to complete tasks for which she had been engaged, failure to return client records upon request, representing herself to be a certified public accountant at

a time when her license had been suspended, and failure to respond to the Board regarding the matter.

Appellee subsequently filed a petition to nullify the state court judgment. On March 24, 1993, after a full hearing, the court dismissed appellee's petition. On March 30, 1993, appellee filed for bankruptcy under Chapter 7. Appellants filed a complaint in the bankruptcy proceedings to have the judgment debt declared nondischargeable as a debt for money obtained by false pretense, false representation, or actual fraud under 11 U.S.C. § 523(a)(2)(A), as a debt for fraud or defalcation while acting in a fiduciary capacity under § 523(A)(4), and/or as a debt for willful and malicious injury under § 523(a)(6).

On May 22, 1995, after a full trial, the Bankruptcy Court issued its Memorandum Opinion, concluding that the state court judgment did not preclude litigation of the nondischargeability issues and that appellants had failed to carry their burden of proving that the debt owed them satisfies the requirements of nondischargeability under 11 U.S.C. § 523(a)(2)(A), (a)(4), or (a)(6).

II. ANALYSIS: Appellants have appealed the Bankruptcy Court's decision, asserting that the Bankruptcy Court erred as follows: 1) in not giving res judicata or collateral estoppel effect to the state court judgment; 2) in finding that appellee did not commit fraud or false representation; 3) in concluding that appellee was not a fiduciary and in finding that no defalcation occurred; and 4) in finding that appellee did not engage in willful and

malicious conduct.[2] Although this Court reviews conclusions of law de novo, the Bankruptcy Court's findings of fact may not be set aside unless found to be clearly erroneous, giving due regard to the Bankruptcy Court's opportunity to judge the credibility of witnesses. Fed. R. Bankr. P. 8013.

A. **Collateral Estoppel:** The appellants correctly state the law of issue preclusion that must be applied with regard to the state court judgment at issue. The preclusive effect that must be given a state court judgment is set forth in 28 U.S.C. § 1738, which provides that the "judicial proceedings of any court of any . . . state shall have the same full faith and credit in every court within the United States . . . as they have by law or usage in the courts of such State . . . from which they are taken." 28 U.S.C. § 1738; see In re Garner, 56 F.3d 677, 679 (5th Cir. 1995). In other words, in determining whether a state court judgment bars relitigation of an issue, a federal court may not apply the federal rules of collateral estoppel, but must "refer to the preclusion law of the State in which judgment was rendered." Garner, 56 F.3d at 679 (quoting Marrese v. American Academy of Orthopaedic Surgeons, 470 U.S. 373, 380 (1985)). So, in determining the effect of the Louisiana state court judgment in this matter, this Court must look to Louisiana's law of preclusion. In Louisiana, "[a] judgment in favor of either the plaintiff or the defendant is conclusive, in any subsequent action between

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[2]Appellants further assert that the Bankruptcy Court erred in making findings of fact that were contrary to the evidence. However, this assertion of error is subsumed in the other issues presented and thus will not be addressed separately.

them, with respect to any issue actually litigated and determined if its determination was essential to that judgment." La. Rev. Stat. Ann. § 13:4231(3) (West 1991).

Appellants are also correct that "'collateral estoppel principles do indeed apply in discharge exception proceedings pursuant to § 523(a)'" and that a bankruptcy court may "under certain circumstances, give collateral estoppel effect to a state court default judgment." Garner, 56 F.3d at 681 (quoting Grogan v. Garner, 498 U.S. 279, 284 n. 11 (1991)). The Court further agrees with appellants that because under Louisiana law a judgment of default must be confirmed by evidence sufficient to establish a prima facie case, a Louisiana default judgment, like the Texas "post-answer" default at issue in Garner,[3] satisfies the collateral estoppel requirement that the issue be "actually litigated." See La. Code Civ. Proc. Ann. art. 1702 (West 1990 & Supp. 1995).

Where the Court must part from appellants' analysis is their argument that the issues before the Bankruptcy Court in determining nondischargeability under § 523(a)(2)(A) were necessarily determined by the state court when it confirmed the default judgment. Appellants argue that it is ascertainable from the face of the state court judgment that the state court determined that appellants had established the prima facie elements of fraud. With this the Court agrees. To make out a claim of fraud under Louisiana law, one must prove 1) a misrepresentation or a suppression of the truth, and 2) that

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[3]The Court notes that the Bankruptcy Court did not have the benefit of Garner's guidance, as it was decided one month after the Bankruptcy Court issued its opinion.

the misrepresentation or suppression was made with the intent "either to obtain an unjust advantage for one party or to cause a loss or inconvenience to the other." La. Civ. Code Ann. art. 1953 (West 1987). However, to establish that a debt is for money obtained by "false representation or false pretense" under § 523(a)(2)(A), the debtor's representation must have been: "'(1)[a] knowing and fraudulent falsehood[], (2) describing past or current facts, (3) that [was] relied upon by the other party.'" Recoveredge L.P. v. Pentecost, 44 F.3d 1284, 1292-93 (5th Cir. 1995) (quoting Allison v. Roberts, 960 F.2d 481, 483 (5th Cir. 1992)). Thus, while the elements of misrepresentation and intent may be substantially the same under Louisiana law and § 523(a)(2)(A), the latter clearly requires the additional element of reliance.[4]

It is true that appellants, in their memorandum in support of confirmation of default judgment, made the allegation that appellants had relied to their detriment upon appellee's alleged misrepresentation that she had filed the tax returns. However, the state court's judgment does not address this or any other allegation specifically. Thus, since a determination of the reliance issue was not

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[4]The elements of "actual fraud" under § 523(a)(2)(A) also include reliance. To establish nondischargeability under the "actual fraud" theory, a creditor must prove: (1) that the debtor made representations, (2) which the debtor knew were false, (3) made with the intention and purpose to deceive the creditor, (4) that the creditor relied on the representations and (5) that the creditor sustained losses as a proximate result of the representations. Recoveredge, 44 F.3d at 1293.

essential to the state court's rendering of judgment on the fraud claim, this Court agrees with the Bankruptcy Court that it is impossible to determine, without written findings or a transcript of oral findings from the state court, whether the state court addressed reliance.

Appellants argue that it is unfair to penalize them for not introducing a transcript of the default confirmation hearing since it is not their fault that the court reporter misplaced the notes from the proceeding. Yet it is the appellants who bear the burden of establishing issue preclusion. Under the circumstances, without the transcript or some form of findings on the part of the state court, the Court cannot conclude that collateral estoppel lies.

**B. False Pretenses, False Representation, or Actual Fraud Under § 523(a)(2)(A):**

Appellants argue that the Bankruptcy Court erred in finding that appellants failed to prove that the debt was nondischargeable under the "false pretenses" or the "actual fraud" theory of § 523(a)(2)(A). As stated earlier, to establish that a debt is for money obtained by "false representation or false pretense," a creditor must prove the debtor's representation was "'(1) [a] knowing and fraudulent falsehood[], (2) describing past or current facts, (3) that [was] relied upon by the other party.'" Recoveredge, 44 F.3d at 1292-93 (quoting Allison v. Roberts, 960 F.2d 481, 483 (5th Cir. 1992)). To establish nondischargeability under the "actual fraud" theory, a creditor must prove: (1) that the debtor made

representations, (2) which the creditor knew were false, (3) made with the intention and purpose to deceive the creditor, (4) that the creditor relied on the representations and (5) that the creditor sustained losses as a proximate result of the representations. Recoveredge, 44 F.3d at 1293.

As grounds for nondischargeability under § 523(a)(2)(A), appellants asserted that appellee: 1) represented herself to be a Certified Public Accountant ("CPA") when she was not; 2) represented that she had filed quarterly tax returns and had performed other accounting services when she had not; and 3) took appellants' business records and refused to return them.

1. **Misrepresentation of CPA Status**: With regard to appellee's misrepresentation of her status as a CPA, the Bankruptcy Court believed appellee's testimony that at the time appellee was engaged by appellants, appellee did not know that her license had been suspended, and thus, did not state a "knowing" falsehood when she used letterhead identifying herself as a CPA. Appellants argue that it was error to believe appellee's testimony on this topic in light of her history of claiming to have not received notices, subpoenas, certified letters, etc. However, unlike the Bankruptcy Court, this Court has had no opportunity to observe appellee's demeanor on the stand and thus is unable to say that the Bankruptcy Court was clearly erroneous in believing appellee's testimony in this regard.

2. **Failure to Perform Services as Agreed**: Appellants' second asserted basis for nondischargeability under § 523(a)(2)(A) centers around appellee's alleged

failure to file appellants' 1990 tax returns and subsequent misrepresentation that she had done do [sic]. In addition, appellants charge that appellee billed them for other services that she had not in fact performed. With regard to the tax filings, the Bankruptcy Court considered the existence or nonexistence of a power of attorney to be important. Although appellant Creely testified that she had signed a power of attorney, the alleged document was never produced at trial, and the Bankruptcy Court believed appellee's testimony that no power of attorney was ever executed. Thus, the Bankruptcy Court accepted appellee's representation that she was obligated only to prepare the tax returns, not to file them.[5] Likewise, with respect to appellee's alleged statements that she had filed the returns,

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[5]Appellants argue that appellee not only failed to file the returns but also failed to prepare them. Appellants suggest that the tax returns produced by appellee at trial were not actually prepared in 1991, as represented by appellee, but were fraudulently created by appellee after litigation had commenced between the parties. In support of this attack on appellee's evidence, appellants point to certain inaccuracies contained in the returns and appellee's failure to perform certain accounting work that, according to appellants, would have been necessary to prepare accurate returns. However, while these mistakes might tend to impeach appellee's testimony that she did prepare the returns timely, appellants confronted appellee with these alleged inconsistencies in their cross examination of her. See Trial Transcript pp. 240-54. The Bankruptcy Court, after observing her demeanor in responding to this line of questioning, nevertheless believed her testimony that she had prepared the returns as agreed. This Court finds no clear error.

the Bankruptcy Court accepted appellee's testimony that she had not made any such statements. As for the reduction in the services performed by appellee in 1991, the Bankruptcy Court found this to be adequately explained by appellee's testimony that she had prepared only tax returns in 1991 because appellant Creely was having personal and financial troubles at the time. All of the Bankruptcy Court's findings in this regard turned on credibility judgments. As it is not for this Court to substitute its judgment for that of the Bankruptcy Court in the realm of witness credibility, this Court does not find the Bankruptcy Court's findings to be clearly erroneous.

3. **Failure to Return Records**: The Bankruptcy Court found it more likely than not that appellee had returned to the appellants all documents in appellee's possession. In addition, the Bankruptcy Court went on to find that even if all documents had not been returned, appellee did not deliberately withhold or fail to return documents with an intent to deceive. Once again, the Bankruptcy Court's findings hinge on the credibility of witnesses, and this Court does not find them clearly erroneous.

**B. Fraud or Defalcation While Acting in a Fiduciary Capacity:**

Appellants argue that the Bankruptcy Court erred in holding that appellee was not acting in a fiduciary capacity and in finding no defalcation, thus concluding appellants had failed to establish that the debt was nondischargeable under § 523(a)(4). This Court need not address whether the Bankruptcy Court erred in holding that appellee was not acting in a fiduciary capacity, for the

Bankruptcy Court went on to find that, even if a fiduciary relationship did exist between appellee and appellants, appellants had failed to prove that appellee had committed defalcation, which finding is not clearly erroneous.

"'Defalcation' includes willful neglects of duty unaccompanied by fraud or embezzlement." See In re Davis, 3 F.3d 113, 115 (5th Cir. 1993). Appellants claim for nondischargeability under § 523(a)(4) is based on the same factual allegations asserted in connection with their § 523(a)(2)(A) claim. Obviously relying upon the same testimony discussed above, the Bankruptcy Court found that appellants had failed to prove these allegations by a preponderance of the evidence and thus had failed to prove any "willful neglect" on appellee's part. For the same reasons set forth above in connection with this Court's rulings regarding appellants' 523(a)(2)(A) claim, this Court finds no clear error.

C. Willful or Malicious Injury:

Finally, appellants argue that the Bankruptcy Court erred in finding that appellants had failed to establish that the debt was for a "willful and malicious injury" and thus nondischargeable under § 523(a)(6). Appellants' claim for nondischargeability under 523(a)(6) is based on the same allegations asserted in connection with their claims under 523(a)(2)(A) and 523(a)(4).

The standard for establishing "willful and malicious" is a strict one. To be nondischargeable under 523(a)(6), a debt must be for "a wrongful act done intentionally, which necessarily produces harm and is

without just cause or excuse." See In re Quezada, 718 F.2d 121, 123 (5th Cir. 1983). Acts done with reckless disregard do not suffice. Id. Again relying upon the same testimony discussed above, the Bankruptcy Court found that appellants had failed to prove that any acts committed by appellee were done intentionally. As it is not for this Court to substitute its judgment as to the credibility of witnesses, this Court can find no clear error.

For the foregoing reasons, the judgment of the Bankruptcy Court is AFFIRMED.

Done this 5th day of February, 1996

New Orleans, Louisiana

/s/
UNITED STATES DISTRICT JUDGE

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF LOUISIANA

IN THE MATTER OF

**CHARLOTTE A. DORAND**

**BANKRUPTCY NO. 93-11136-JAB**

DEBTOR

CHAPTER 7

**RIGHT UP YOUR ALLEY, INC. and ARLENE L. CREELY**

PLAINTIFFS

v.

**ADVERSARY NO. 93-1162**

**CHARLOTTE A. DORAND**

DEFENDANT

## MEMORANDUM OPINION

This proceeding came on for trial on January 19, 1995 on the complaint and first amended complaint of Right Up Your Alley, Inc. ("RUYA") and Arlene L. Creely ("Creely") to have debt determined nondischargeable under 11 U.S.C. § 523(a)(2)(A), (a)(4), (a)(6), and (a)(11).[1] After listening to the evidence and

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[1]Section 523(a)(11) involves debts owed to federal depository institutions or insured credit unions, and was

reviewing the exhibits and pleadings, the court makes the following findings of fact and conclusions of law.[2]

## I. Facts

Dorand's certificate and license to practice public accounting was suspended on March 1, 1990 for failure to pay the annual renewal fee. (Testimony of Clinton Cognevich; Memorandum Opinion of October 17, 1994 in Adversary No. 94-1046-JAB at 2). Dorand testified that she was unaware she was suspended until much later.

In 1990, Creely retained the debtor to perform certain accounting and tax services on her behalf and on behalf of her business, RUYA, a full service hair salon. (D. Ex. 1(a)). The first page of the two page retention agreement prepared by the debtor on her letterhead is dated August 6, 1990; however, the second page of the letter indicates acknowledgment of the agreement by Creely on May 12, 1990. Id. The debtor's work product evidences that she was working for the plaintiffs in May of

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apparently listed in error because the plaintiffs' post trial brief did not discuss this section. Section 523(a)(11) is clearly inapplicable, so the court will deny the complaint with respect to the Section 523(a)(11) allegations.

[2]This memorandum opinion constitutes the court's findings of fact and conclusions of law in accordance with Bankruptcy Rule 7052. The court has jurisdiction over the matter under 28 U.S.C. § 1334. The matter is a core proceeding under 28 U.S.C. § 157(b)(2).

1990. (P. Ex. A(4) and A(5)). Although the testimony of Creely and Dorand differed as to why there was a discrepancy on the dates, both of them identified the letter as bearing Creely's signature.

Creely and Dorand both testified that Dorand would periodically pick up RUYA's original financial records in order to perform the accounting work. (D. Ex. 1(a)). They also agreed that, at least in 1990, Dorand was supposed to prepare bank reconciliations, city sales tax returns, payroll tax returns, a general ledger, general journals, cash receipt and disbursement journals, payroll journals, financial statements, quarterly federal returns, corporate tax returns, and personal tax returns for Creely and RUYA. Dorand was to be paid $275.00 a month for these services. (D. Ex. 1(a)). Creely testified that she would also do Dorand's hair as part of the compensation, but Dorand denied this and the retention agreement is silent on this point.

The testimony of Creely and Dorand was contradictory on virtually all other relevant issues.

Creely testified that Dorand brought a power of attorney during one of Dorand's visits to the salon, and that she signed it, giving Dorand the power to act on her behalf in filing tax returns. The power of attorney was not introduced into evidence.

Creely testified that in September or October of 1990 or 1991,[3] she began hearing from the Internal

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[3]Although she was unsure of the date, based on the testimony of other witnesses it must have been 1991.

Revenue Service ("IRS") that RUYA's quarterly tax returns had not been filed. When Dorand next came to pick up records from RUYA, Creely told Dorand that she had heard from the IRS. Dorand told her that (1) the quarterly tax returns had been filed with the IRS, (2) she should not talk to the IRS anymore, (3) Dorand would handle it, and (4) if Creely spoke to the IRS it would only make things worse. Creely stated that she believed Dorand because Dorand was a CPA. When the IRS called again, Creely asked them to contact Dorand. Creely stated that in November, 1991, the IRS contacted her and said that after repeated attempts to contact Dorand, they had been unsuccessful. Creely stated that she did not ask the IRS to give her a copy of the statements Dorand had supposedly filed with the IRS, but instead asked Dorand to give her copies of what had been given to the IRS.

Creely testified that she then asked Linda Savage ("Savage"), RUYA's shop manager, to make a list of all the documents that Creely would need to talk to the IRS because Dorand had all the original records for RUYA. In November, 1991, she first asked Dorand to return her records. She repeatedly asked Dorand to return her records, but to this day still has not received all of the records. Creely stated that Dorand did perform some of the services, but stopped performing all services in the summer of 1991.

Savage testified that Dorand was the CPA for RUYA from May, 1990 to December, 1991. She stated that Dorand did the accounting work for RUYA and Creely through September 30, 1990, but did not do the work timely in the last quarter of 1990 because she got behind and claimed her computer system was down. Savage testified that in 1991 she was only working part

time for RUYA, and she asked Robin (the receptionist) if any work was coming back from Dorand. Robin told Savage that Robin gave Dorand the RUYA records every month, but that Dorand never brought anything back. Based on this, Savage thought Dorand did not do any work for the plaintiffs in 1991. Savage stated that she believed Creely executed a power of attorney in favor of Dorand, but that she never saw it.

Dorand testified that in 1990 she prepared financial statements, general ledgers, sales tax returns, payroll tax returns, corporate tax returns, and personal tax returns. In 1991, Creely was having financial and personal problems, so Dorand only prepared the sales tax returns and pay roll tax returns so Creely would not have problems with the tax authorities. Dorand testified that she and Robin (RUYA's employee who replaced Savage) made Creely aware in August, 1991 that Creely was not paying her taxes. Dorand stated that Robin came to her office in August, 1991, and they went through Creely's files and made a list of what Creely owed. They then met with Creely and explained that she was not paying taxes, and tried to estimate how much money she would need. Creely told Dorand that she would sell her jewelry and her car to pay the taxes.

Dorand stated that she did not have a power of attorney from Creely to file Creely's and RUYA's tax returns, and that she generally did not file her clients' tax returns because the client must sign and write any checks.[4]

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[4]Donald J. Murphy ("Murphy"), a CPA for 18 years who now does the tax returns for Creely and RUYA, testified as a witness for plaintiffs. He testified that he

She stated that she returned two boxes of documents directly to Robin, and in December, 1991 returned another box. She stated that Creely was provided with copies of her work product, and that she returned all original bank statements, checks and other documents in the three boxes. Dorand testified that she terminated the employment relationship with Creely and RUYA in December, 1991. On January 25, 1992, Dorand corresponded with Creely, outlined some of Creely's tax and business problems that required immediate attention lest they worsen, and stated that a balance of $2,475.00 was still owed to Dorand from Creely. (D. Ex. 1(b)).

On January 29, 1992, Lindsey M. Bailleux (now Ladouceur) ("Ladouceur"), attorney for Creely, appeared at Dorand's offices and was given access to the files pertaining to Creely and RUYA. Ladouceur took possession of a box of records and documents, and initialed receipt of the documents on a letter prepared by Dorand. (D. Ex. 1(c)). Ladouceur indicated on the letter that certain items were not there, and Dorand said she would mail them. (Id.) Ladouceur testified that when she returned to the office some of the documents that she had signed for as being present were in fact not in the box. Consequently, she directed Savage to prepare a letter itemizing the documents that were still missing. (P. Ex. 5).

Deborah Cotton ("Cotton"), Dorand's receptionist, testified that Ladouceur was given unlimited access to the

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does not file tax returns for his clients because the clients need to sign them and need to furnish checks to pay the taxes.

files, and left with some documents. She further stated that someone from Creely's office had come a few days before Christmas, and Dorand gave this person a box of papers.

Dorand introduced into evidence an exhibit that contained a copy of most of the work she performed for RUYA and Creely. (D. Ex. 3). She stated that the exhibit comprised approximately 95% of the work she performed.

The plaintiffs filed suit in the 24th Judicial District Court for the Parish of Jefferson alleging breach of contract, negligence, conversion, payment of a thing not due, unfair and deceptive trade practices, fraud, and a debt on an open account. Domiciliary service was made on Dorand by leaving a copy of the petition at the debtor's home with the debtor's teenage son. The debtor was in Paris, France at the time of the service. When the debtor did not respond, the plaintiffs moved for a default judgment. (P. Ex. 6). Although the plaintiffs introduced witness testimony at the hearing on confirmation of the default judgment (See P. Ex. 8 at 93), no transcript of the testimony was introduced into evidence. The state court judge entered judgment in favor of the plaintiffs on April 7, 1992 for actual damages of $11,700.57, general damages of $7,500.00, attorney's fees and costs of $4,505.15 plus legal interest and costs. (P. Ex. 7). The judgment states in pertinent part:

> IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, that judgment be rendered in favor of the plaintiffs and against the defendant, Charley A. Dorand, on the allegations of breach of contract, negligence, conversion, payment

of a thing not due, unfair and deceptive trade practices, fraud, and open account.

(Id.) There were no written findings or reasons in support of the judgment.

The debtor filed for protection under Chapter 7 of the Bankruptcy Code on March 30, 1993.

## II. Analysis

### A. Burden of Proof

The party seeking to establish that a debt is nondischargeable or objecting to the dischargeability of a debt bears the burden of proof under Section 523 by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991).

### B. Collateral Estoppel

The plaintiffs argue that the doctrine of collateral estoppel applies to the findings rendered in the Civil District Court litigation. Dorand disputes this assertion.

The doctrine of collateral estoppel is applicable if (1) the issue at stake is identical to the one involved in the prior litigation; (2) the issue was actually litigated in the prior litigation; and (3) the determination of the issue in the prior litigation was a critical and necessary part of the

judgment in the earlier action. Recoveredge L.P. v. Pentecost, 44 F.3d 1284, 1290 (5th Cir. 1995).

The elements necessary to apply the doctrine of collateral estoppel in bankruptcy courts were set forth in the recent Fifth Circuit case of Dennis v. Dennis (In re Dennis, 25 F.3d 274, 278 (5th Cir. 1994), which stated:

> Collateral estoppel applies in bankruptcy courts only if, inter alia, the first court has made specific, subordinate, factual findings on the identical dischargeability issue in question—that is, an issue which encompasses the same prima facie elements as the bankruptcy issue—and the facts supporting the court's findings are discernible from that court's record. [emphasis in original].

The Fifth Circuit further stated:

> Bankruptcy courts must therefore look beyond the labels which state courts—and even parties themselves—give obligations which debtors seek to have discharged. [citations omitted]. Indeed, the mere fact that a creditor previously reduced her claim to a judgment does not preclude the bankruptcy court from inquiring into the true nature of the debt—and ruling contrary to the first court's judgment, if necessary.
>
> . . .
>
> The reason for these well-settled principles is that parties and state courts, as

> a general rule, do not label obligations with federal bankruptcy standards in mind. [emphasis in original].

Dennis, 25 F.3d at 277-78.

Application of these well-settled principles compels this court to reject the plaintiffs' argument that collateral estoppel applies to the state court judgment. The state court made no specific, subordinate, factual findings in support of its judgment. Only the finding of fraud contains at least some of the prima facie elements of Section 523(a)(2) and (a)(4), but there are no specific factual findings that all the elements of fraud as provided for in Section 523(a)(2)(A) ("actual fraud") or (4) ("fraud while acting in a fiduciary capacity") were involved in that portion of the state court judgment that may have been based on fraud only. The remaining grounds on which the state court granted judgment—breach of contract, negligence, conversion, payment of a thing not due, unfair and deceptive trade practices, and open account—have different prima facie elements from the bankruptcy issues provided for in Section 523(a)(2), (a)(4), and (a)(6). Therefore, collateral estoppel may not be applied to find the debt nondischargeable under Section 523.

C. Applicability of Section 523(a)(2), (a)(4), and (a)(6)

The plaintiffs argue that if the doctrine of collateral estoppel is not applicable, then they have proved the elements of nondischargeability under Section 523(a)(2), (a)(4), and (a)(6).

Section 523(a) of the Bankruptcy Code excepts from discharge any debt:

> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
>
> (A) false pretenses, a false representation, or actual fraud, . . .;
>
> . . .
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;
>
> . . .
>
> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity".

1. Section 523(a)(2)(A)

Generally, debts falling within Section 523(a)(2)(A) are debts obtained by frauds "involving moral turpitude or intentional wrong, and any misrepresentations must be knowingly and fraudulently made." In re Martin, 963 F.2d 809, 813 (5th Cir. 1992), citing, In re Foreman, 906 F.2d 123, 127 (5th Cir. 1990); Recoveredge, 44 F.3d at 1297.

Section 523(a)(2)(A) distinguishes between "actual fraud" on the one hand, and false pretenses and

representations on the other. Recoveredge, 44 F.3d at 1292, citing, Bank of Louisiana v. Bercier (In re Bercier), 934 F.2d 689, 692 (5th Cir. 1991).

For a debtor's statement to be a "false representation or false pretense" under Section 523(a)(2), it must have been: (1) a knowing and fraudulent falsehood, (2) describing past or current facts, (3) that was relied upon by the other party. Recoveredge, 44 F.3d at 1293, citing, Allison v. Roberts (In re Allison), 960 F.2d 481, 483 (5th Cir. 1992). False representations must concern present or past asserted facts. Bercier, 934 F.2d at 692. Representations or promises to do future actions do not qualify unless the debtor never intended to perform. Id.; In re Rubin, 875 F.2d 755, 759 (9th Cir. 1989); Green v. Pawlinski (In re Pawlinski), 170 B.R. 380, 393 (Bankr. N.D. Ill. 1994).

For a debtor's statement to be "actual fraud", the creditor must prove that: "(1) the debtor made representations; (2) at the time they were made the debtor knew they were false; (3) the debtor made the representations with the intention and purpose to deceive the creditor; (4) that the creditor relied on such representations; and (5) that the creditor sustained losses as a proximate result of the representations." Recoveredge, 44 F.3d at 1293, citing, Keeling v. Roeder (In re Roeder), 61 B.R. 179, 181 (Bankr. W.D. Ky. 1986).

The plaintiffs argue that Dorand misrepresented that she was a CPA. It is beyond dispute that Dorand's CPA license was suspended on March 1, 1990 for failure to pay the annual fee to renew the certificate and license. Consequently, the retainer agreement dated August 6, 1990 on Dorand's letterhead did incorrectly state that

Dorand was a "Certified Public Accountant". See D. Ex. 1(a). Dorand testified, however, that she was not aware her license had been suspended at that time, and only became aware of it much later (presumably when the state CPA licensing board took further action on Dorand's license). The plaintiffs did not introduce any evidence that Dorand knowingly misrepresented she was a CPA. This alleged misrepresentation is insufficient under Section 523(a)(2).

The plaintiffs also allege that Dorand misrepresented that she had filed the quarterly tax returns for 1991 when she had not, and told Creely not to talk with the IRS because it "would only make things worse". Dorand denied making any such statements and testified that she did prepare the quarterly returns. Included within Defendant's Exhibit 3 are the quarterly federal and state tax returns for the first, second, and third quarters of 1991.[5] (D. Ex. 3). The returns are unsigned, but this is consistent with Dorand's testimony that Creely filed the returns and not Dorand. Dorand testified that the original returns were forwarded to Creely. In addition, the bill Dorand sent to Creely on January 25, 1992 includes preparation fees for first, second, and third quarter 1991 payroll tax returns. (D. Ex. 1(b)).

Although Creely stated she gave Dorand a power of attorney to file her returns, no such document was introduced into evidence.

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[5]Dorand did not prepare the fourth quarter returns because she was not working for Creely as of the end of December, 1991.

The plaintiffs have failed to carry their burden of proving that Dorand made any misrepresentations or committed actual fraud with respect to these alleged representations.

Plaintiffs' last category of alleged misrepresentations is that Dorand did not return all of RUYA's original records, and that as a consequence, Creely had to obtain copies from her bank to complete the necessary returns. The plaintiffs have also failed to carry their burden on this point. Dorand testified that the documents were returned in three boxes; she also testified that her offices had been robbed, and that some of Creely's documents may have been messed up during the robbery. Although it is unclear which documents have not been returned, the court finds that it is more likely than not that all of the documents that Dorand still had were returned. Even assuming that not all of the documents were returned, however, this is an insufficient basis to deny dischargeability of a debt under Section 523(a)(2). The failure to return the documents does not rise to the level of false representations or pretenses, or actual fraud. There is no indication that Dorand deliberately withheld plaintiffs' documents or failed to return the boxes with intent to deceive. There is no proof that the failure to return the documents caused any of the plaintiffs' problems with the IRS.

The plaintiffs have failed to prove the elements of nondischargeability under Section 523(a)(2).

## 2. Section 523(a)(4)

Section 523(a)(4) requires that the fraud or defalcation occur while the debtor was acting in a fiduciary capacity. In determining whether a debtor was acting in a fiduciary capacity, the court must look to both state and federal law. The scope of the concept of fiduciary under 11 U.S.C. § 523(a)(4) is a question of federal law; however, state law is important in determining whether or not a trust obligation exists. Bennett v. Bennett (In re Bennett), 989 F.2d 779, 784 (5th Cir. 1993), citing, Angelle v. Reed (In re Angelle), 610 F.2d 1335, 1339 (5th Cir. 1980). In Angelle, the Fifth Circuit held that the concept of fiduciary under Section 523(a)(4) is narrowly defined, and applies only to technical or express trusts, not those which the law implies from the contract. In Bennett, 989 F.2d at 784-85 (5th Cir. 1993), the Fifth Circuit recognized that "[m]ost courts today, however, recognize that the 'technical' or 'express' trust requirement is not limited to trusts that arise by virtue of a formal trust agreement, but includes relationships in which trust-type obligations are imposed pursuant to statute or common law." In support of this proposition, the Fifth Circuit cited the case of In re Moreno, 892 F.2d 417, 421 (5th Cir. 1990), holding that an officer of a corporation owed a common law fiduciary duty to a corporation and the stockholders sufficient to satisfy the requirements of Section 523(a)(4). Bennett, 989 F.2d at 785.

"Defalcation" includes willful neglects of duty unaccompanied by fraud or embezzlement. Sheerin v. Davis (In re Davis), 3 F.3d 113, 115 (5th Cir. 1993).

Plaintiffs argue that the debtor breached the duty arising from her fiduciary capacity by (1) not performing

the accounting work she was retained to perform; (2) not filing the tax returns she was retained to file; (3) misrepresenting to plaintiffs that she had filed tax returns and completed accounting work when in fact she had not; (4) accepting free services from plaintiff to offset plaintiffs' account with debtor which was not due; (5) accepting payment from plaintiffs for work that had not been performed; and (6) failing to return plaintiffs' financial records and receipts.

The difficulty with plaintiffs' argument is that it concentrates on the breaches of the fiduciary duty without showing first that a fiduciary obligation was owed. Plaintiffs simply ask this court to assume Dorand owed a fiduciary obligation to plaintiffs. The plaintiffs cite no legal authority for the proposition that CPA's owe fiduciary obligations to their clients. The court has been unable to locate any decision so holding or even involving this argument.

The plaintiffs cite the Uniform Fiduciaries Law which defines "fiduciary" as:

> . . . a trustee under any trust, expressed, implied, resulting or constructive, executor, administrator, guardian, conservator, curator, receiver, trustee in bankruptcy, assignee for the benefit of creditors, partner, agent, officer of a corporation, public or private, public officer, or <u>any other persons acting in a fiduciary capacity</u> for any person, trust or estate.

La.R.S. 9:3801(2). The Uniform Fiduciaries Law applies to four classes of persons: (1) persons paying money or

transferring other property to fiduciaries; (2) corporations whose securities are registered in the names of fiduciaries; (3) persons receiving negotiable instruments; and (4) depositories of fiduciary funds. Commissioner's Prefatory Note to Uniform Fiduciaries Law, La.R.S. 9:3801, at p. 434 (West 1991). The plaintiffs have not shown that the Uniform Fiduciaries Law applies to this case.

The plaintiffs also cite Office of Commissioner of Insurance v. Hartford Fire Insurance Co., 623 So.2d 37, 40 (La. App. 1st Cir. 1993), which stated:

> One is said to act in a "fiduciary capacity", when the business which he transacts, or the money or property he handles, is not his own or for his own benefit, but for the benefit of another person, as to whom he stands in a relation implying and necessitating great confidence and trust on the [one] part and a high degree of good faith on the other part."

The plaintiffs failed to include the following additional language from the case:

> The term is not restricted to technical or express trusts, but includes also such offices or relations as those of an attorney at law, a guardian, an executor, a broker, a director of a corporation, and a public officer.

Id. Accountants are not included within the list of fiduciaries. The case itself held that there was no fiduciary relationship between the Louisiana Patient's Compensation Fund and a medical malpractice insurer.

Hartford does not support the plaintiffs' argument that Dorand's employment as a CPA for the plaintiffs resulted in a fiduciary relationship. If Dorand had been given a power of attorney, a fiduciary relationship might have existed. As discussed previously, however, no power of attorney was introduced into evidence. The court finds credible Dorand's testimony that she had not been given a power of attorney and could not file the plaintiffs' tax returns because she did not have checkwriting authority for the plaintiffs.

Assuming for a moment that a fiduciary relationship did exist, the plaintiffs did not prove by a preponderance of the evidence their allegations that Dorand: (1) did not perform the accounting work she was retained to perform; (2) did not file the tax returns she was retained to file; (3) misrepresented that tax returns had been filed when they had not; (4) accepted free services from plaintiffs to offset plaintiffs' account with debtor; and (5) accepted payment from plaintiffs for work that had not been performed. Plaintiffs did prove that Dorand may not have returned all the original documents of RUYA and Creely. This is insufficient to prove a defalcation while acting in a fiduciary capacity. Furthermore, the plaintiffs did not introduce evidence that Dorand's actions caused her injuries. Although Murphy, the subsequent accountant, testified that the tax returns for 1990 were not filed prior to March, 1992, there was no evidence that the IRS assessed any penalties as a result. Although the plaintiffs did introduce evidence as to costs incurred by hiring Murphy and evidence of attorneys' fees incurred, including prosecution of the state court case, there is a lack of evidence that these costs were caused by a defalcation by Dorand in breach of a fiduciary capacity.

Accordingly, the plaintiffs' claim under Section 523(a)(4) must be denied.

3. Section 523(a)(6)

In the case of In re Quezada, 718 F.2d 121, 123 (5th Cir. 1983), the Fifth Circuit, citing Collier on Bankruptcy, stated as follows:

> In order to fall within the exception of section 523(a)(6), the injury to an entity or property must have been willful and malicious. An injury of an entity or property may be a malicious injury within this provision if it was wrongful and without just cause or excessive, even in the absence of personal hatred, spite or ill-will. The word "willful" means "deliberate or intentional", a deliberate and intentional act which necessarily leads to injury. Therefore, a wrongful act done intentionally, which necessarily produces harm and is without just cause or excuse, may constitute a willful and malicious injury.

Injuries within the meaning of Section 523(a)(6) are not confined to physical damage or destruction but also include an injury to intangible personal or property rights. Greene v. Ellis, 152 B.R. 211, 215 (Bankr. E.D. Tenn. 1993).

The court has not found any cases holding the debts of a CPA or an accountant for malpractice are nondischargeable under Section 523(a)(6). Legal malpractice may constitute willful and malicious injury if the debtor's conduct was an intentional act which necessarily leads to injury. In re Keller, 106 B.R. 639 (Bankr. 9th Cir. 1989). Similarly, the case of In re Muhammad, 135 B.R. 294, 298 (Bankr. N.D. Ill. 1991), held that the debtor/lawyer's conduct was malicious if he was substantially certain that his actions or inactions would result in injury, but acted or omitted to act in disregard of that knowledge.

This is not a case calling for an extension of the legal malpractice rule expressed in Keller and Muhammad to an accountant's alleged malpractice. The plaintiffs have not shown that Dorand performed intentional acts that would necessarily lead to injury. Dorand's listing herself as a CPA when her license had been suspended was not intentional. Dorand had reasonable responses to all of Creely's other assertions and the court finds the responses to be credible. Dorand's work product included the quarterly tax returns for the first three quarters of 1991. No duty was shown requiring Dorand to file the tax returns. It is true that Dorand probably did not return all the original records of RUYA and Creely, but this is a far cry from the willful and malicious injury required by Section 523(a)(6). Finally, the plaintiffs failed to prove that Dorand's willful and malicious conduct caused them any injury. Plaintiffs have failed in their burden of proving the debtor acted willfully and maliciously under Section 523(a)(6).

A judgment will be entered in accordance with this memorandum opinion.

New Orleans, Louisiana, this 22nd day of May, 1995.

*/s/ Jerry A. Brown*

JERRY A. BROWN
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF LOUISIANA

IN THE MATTER OF

**CHARLOTTE A. DORAND**

DEBTOR

**BANKRUPTCY NO. 93-11136-JAB**

CHAPTER 7

**RIGHT UP YOUR ALLEY, INC. and ARLENE L. CREELY**

PLAINTIFFS

v.

**CHARLOTTE A. DORAND**

DEFENDANT

**ADVERSARY NO. 93-1162**

**ORDER**

For the reasons assigned in the foregoing memorandum opinion issued this date, accordingly,

**IT IS ORDERED, ADJUDGED AND DECREED** that judgment be and it hereby is entered in favor of the debtor/defendant, Charlotte A. Dorand, and against the plaintiffs, Right Up Your Alley, Inc. and Arlene L. Creely, **DISMISSING** the plaintiffs' complaint.

New Orleans, Louisiana, this 22nd day of May, 1995.

*/s/ Jerry A. Brown*
JERRY A. BROWN
UNITED STATES BANKRUPTCY JUDGE

IN THE 24TH JUDICIAL DISTRICT COURT FOR

THE PARISH OF JEFFERSON

STATE OF LOUISIANA

NO. 429-870 DIVISION "F"

RIGHT UP YOUR ALLEY, INC. AND
ARLENE L. CREELY

VERSUS

CHARLEY A. DORAND

JUDGMENT

This cause came on for hearing on February 18, 1993 on the Petition for Injunction and for a Stay Order filed in connection with the Petition for Nullity of Judgment filed by the plaintiff, Charley A. Dorand. Present were the plaintiff, Charley A. Dorand; her attorney of record, Frank J. Uddo; the defendants, Right Up Your Alley, Inc., represented by its President, Arlene L. Creely, and Arlene L. Creely, individually; and their attorney of record, Lindsey M. Ladouceur.

The Court, having heard the testimony of the witnesses and reviewed the documentary evidence, and having considered the facts, evidence, and applicable law, finds, for the reasons orally assigned at the hearing, that the plaintiff, Charley A. Dorand, is not entitled to a preliminary injunction or a permanent injunction in this matter. It is therefore ORDERED, ADJUDGED, AND

DECREED that the plaintiff's request for injunctive relief is denied.

It is further ORDERED, ADJUDGED, AND DECREED that the defendants are entitled to an award of court costs and out-of-pocket expenses, if any, incurred in connection with the temporary restraining order entered on November 6, 1992.

By agreement between the parties and their counsel, the judgment of the Court on the request for injunctive relief is hereby also made the judgment of the Court on the merits of the Petition for Nullity. It is therefore ORDERED, ADJUDGED, AND DECREED that the Petition for Nullity and for a Stay Order be and it is hereby dismissed, with prejudice, at the plaintiff's cost.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED, that the plaintiff's request for a stay of the judgment previously rendered by this Court on April 7, 1992, in Proceeding Number 429-870, pending an appeal of this Judgment, is DENIED.

Gretna, Louisiana, this ___ day of March, 1993.

_____

24th Judicial District Judge

24TH JUDICIAL DISTRICT COURT FOR
THE PARISH OF JEFFERSON

STATE OF LOUISIANA

NO. 429-870 DIVISION "F"

RIGHT UP YOUR ALLEY, INC. and
ARLENE L. CREELY

VERSUS

CHARLEY A. DORAND

JUDGMENT

This cause having come on this day on the Motion for Confirmation of Default Judgment filed by the plaintiffs, Right Up Your Alley, Inc., and Arlene L. Creely, and the Court having considered the allegations of the Petition, the Motion and Memorandum of Plaintiffs, and the documentary evidence and oral testimony adduced at the hearing, and being of the opinion that facts and law preponderate in favor of the plaintiffs, and further finding that the defendant has made no appearance in this case since the entry of a preliminary default on March 27, 1992;

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, that judgment be rendered in favor of the plaintiffs and against the defendant, Charley A. Dorand, on the allegations of breach of contract, negligence, conversion, payment of a thing not due, unfair and deceptive trade practices, fraud, and open account.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED, that the defendant be and she is hereby cast in judgment and ordered to pay actual damages to the plaintiffs in the total amount of **$11,700.57**, general damages of $7,500.00, legal interest from the date of judicial demand, and all costs of these proceedings, including costs of execution and collection.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED, that the defendant be and she is hereby cast in judgment and ordered to pay attorney's fees and costs in the amount of $4505.15.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED, that the defendant be and she is hereby cast in judgment and ordered to pay legal interest from the date of each payment of professional fees by Right Up Your Alley, Inc. until repaid in full.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED, that the defendant, Charley A. Dorand, be and she is hereby ordered to return any and all records of Arlene L. Creely and Right Up Your Alley, Inc., in whatever form, which are in her possession, custody or control.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED, that the defendant, Charley A. Dorand, be and she is hereby ordered to produce copies of any and all city, state, and federal tax returns filed by her on behalf of Arlene L. Creely and/or Right Up Your Alley, Inc. from 1989 to the present.

JUDGMENT READ, RENDERED, AND SIGNED in open Court on April 7, 1992.

/s/
24th Judicial District Judge